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TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 674

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER
vs.
SIDNEY S. MUNTER

No. 675

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER
vs.
CARL MUNTER

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR CERTIORARI FILED NOVEMBER 6, 1946
CERTIORARI GRANTED DECEMBER 16, 1946

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1946

No. 674

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

SIDNEY S. MUNTER

No. 675

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

CARL MUNTER

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

	Original	Print
Record from The Tax Court of the United States.-Docket No. 1162	1	1
Docket entries	1	1
Petition	3	2
Exhibit A—Notice of deficiency	8	4
Answer	12	7
Stipulation of facts	14	8
Joint exhibit 1-A—Agreement between O. McKenzie and Sidney S. and Carl P. Munter, March 21, 1940	24	15
Opinion, Leech, J	33	20
Dissenting opinion, Disney J	44	27
Decision	48	29
Petition for review	49	29
Notice of filing petition for review	50	30
Designation of contents of record on review	51	31
Clerks' certificates [omitted in printing]	52	31

	Original	Print
Record from The Tax Court of the United States, Docket No. 1163	54	31
Docket entries	54	32
Petition	56	33
Exhibit A—Notice of deficiency	60	35
Answer	64	38
Decision	66	39
Petition for review	67	39
Notice of filing petition for review	68	40
Proceedings in U. S. C. C. A., Third Circuit	69	41
Opinion, McLaughlin, J.	69	41
Dissenting opinion, O'Connell, J.	72	44
Judgments	74	46
Clerk's certificate [omitted in printing]	75	47
Stipulation as to record on petition for certiorari	76	48
Orders allowing certiorari	78	49
Stipulation as to record on writs of certiorari	80	49

1 In the Tax Court of the United States

Docket No. 1162

SIDNEY S. MUNTER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: Samuel Kaufman, Esq. For Comm'r: Orris Bennett, Esq., R. C. Whitley, Esq.

Docket entries

1943

Apr. 5—Petition received and filed. Taxpayer notified. Fee paid.

Apr. 5—Copy of petition served on General Counsel.

Apr. 5—Request for hearing at Pittsburgh, Pa., filed by taxpayer. 4/5/43 Granted.

May 15—Answer filed by General Counsel.

May 19—Copy of answer served on taxpayer (Pittsburgh, Pa.).

1944

Jan. 6—Hearing set February 7, 1944—Pittsburgh, Pa.

Feb. 7—Hearing had before Judge Smith, on Petitioner's motion to continue to next Pittsburgh calendar, motion granted. Motion for continuance filed at hearing.

Feb. 25—Transcript of hearing 2/7/44 filed.

Mar. 7—Hearing set April 24, 1944—Pittsburgh, Pa.

Apr. 4—Motion for continuance to next Pittsburgh, Pa. calendar filed by taxpayer.

Apr. 4—Hearing set April 12, 1944, on motion.

Apr. 4—Copy of motion and notice of hearing served on General Counsel.

Apr. 12—Hearing had before Judge Murdock on petitioner's motion for continuance to Fall calendar.

Apr. 12—Motion of April 4, 1944, for continuance—granted to next Fall calendar. Pittsburgh, Pa.

Sept. 25—Hearing set October 23, 1944—Pittsburgh, Pa.

Oct. 30—Hearing had before Judge Leech on merits. Motion of counsel to consolidate—granted. Stipulation of facts filed. Petitioner's brief due 12/11/44. Petitioner's reply due 1/24/45. Comm'rs brief 1/18/45.

Nov. 30—Motion for extension to Jan. 17, 1945, to file brief, filed by taxpayer. 12/4/44 Granted.

Nov. 27—Transcript of hearing Oct. 30, 1944 filed.

1945

Jan. 19—Brief filed by taxpayer. 1/19/45 Copy served.
Feb. 17—Motion for leave to file the attached brief, brief lodged, filed by General Counsel. 2/19/45 Granted.
May 22—Opinion rendered, Judge Leech. Decision will be entered for the respondent. Copies served.
May 23—Decision entered. Judge Leech, Div. 6.
2 June 8—Petition for review by U. S. Circuit Court of Appeals, 3rd Circuit, filed by taxpayer.
June 8—Designation of contents of record filed by taxpayer.
June 8—Notice of filing petition for review sent to J. P. Wenchel filed.
June 12—Proof of service filed.
June 20—Proof of service of designation of contents of record filed.
July 17—Order extending time for transmission and delivery of the record to August 31, 1945 entered.

3 The Tax Court of the United States

[File endorsement omitted.]

Docket No. 1162

SIDNEY S. MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition

Filed April 5, 1943

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:WPM:NCD-90D) dated January 7, 1943, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual with residence at 6582 Beacon Street, Pittsburgh, Pennsylvania. The return for the period here involved was filed with the Collector for the 23rd District of Pennsylvania.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A, was mailed to the petitioner on January 7, 1943.

3. The taxes in controversy are income taxes for the calendar year 1940 and in the amount of $9,596.33.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) Increase of salary income in the amount of $2,048.26.

(b) Addition to income of "dividends" received from Crandall, McKenzie & Henderson, Inc., in the amount of $12,500.00.

(c) Increase of income from partnership in the amount of $549.26.

(d) Disallowance of deduction for legal fees in the amount of $4,500.00.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Throughout the year 1940 petitioner and his brother, Carl Munter, were partners engaged in the operation of a laundry business in the City of Pittsburgh, Pennsylvania.

(b) In April, 1940, petitioner and his brother, Carl Munter, acquired by purchase 20,000 shares (a majority) of the capital stock of Crandall, McKenzie & Henderson, Inc., a Pennsylvania corporation, engaged in the dry cleaning business in the City of Pittsburgh, Pennsylvania, and held these shares throughout the remainder of 1940.

(c) Petitioners and his brother, Carl Munter, became officers and employees of Crandall, McKenzie & Henderson, Inc., and in 1940 received compensation for services rendered to the corporation in the respective amounts of $6,000.00 and $3,403.48.

(d) The oral agreement between petitioner and his brother provided that they should be equal partners not only in the conduct of the laundry business, the income from which was reflected on a partnership return, but as to the acquisition, ownership, management and operation of the affairs of Crandall, McKenzie & Henderson, Inc., including the respective salaries received by them from the corporation.

(e) In connection with the purchase of the shares of Crandall, McKenzie & Henderson, Inc., and the borrowing of funds to finance the purchase, legal fees were incurred in 1940 in the amount of $9,000.00.

(f) Subsequent to April, 1940 Crandall, McKenzie & Henderson, which had neither accumulated nor current earnings or profits, distributed to its shareholders cash in the amount of $1.25 per share.

(g) In its fiscal year ended May 31, 1940 the partnership, composed of petitioner and his brother, paid a bonus of $200.00 to one of its employees and distributed among all of its employees Christmas candy costing $353.52, deduction for which was disallowed by the respondent.

Wherefore, the petitioner prays that this Court may hear the proceeding and disallow the deficiency.

Samuel Kaufman,
SAMUEL KAUFMAN,
RUSLANDER AND KAUFMAN,
First National Bank Bldg., Pittsburgh, Pennsylvania.
Counsel for Petitioner.

[*Duly sworn to by Sidney S. Munter; jurat omitted in printing.*]

Exhibit A to petition

TREASURY DEPARTMENT
INTERNAL REVENUE SERVICE.
2300 FARMERS BANK BUILDING.
Pittsburgh, Pennsylvania, January 7, 1943

Office of Internal Revenue Agent in Charge, Pittsburgh Division

IT:WPM.
NCD-90D.

MR. SIDNEY S. MUNTER,
6582 Beacon Street, Pittsburgh, Pennsylvania.

SIR: You are advised that the determination of your income tax liability for the taxable year 1940 discloses a deficiency of $9,596.33 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Pittsburgh, Penna., for the attention of IT:WPM-NCD. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By (Signed) W. P. MAYS.
Internal Revenue Agent in Charge.

Enclosures: Statement. Form of waiver.
NCD:MMM.

TAX LIABILITY FOR THE TAXABLE YEAR ENDED DECEMBER 31, 1940

	Liability	Assessed	Deficiency
Income tax	$19,408.93	$89,812.60	$89,596.33

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 15, 1942; to your protest dated June 8, 1942; and to the statements made at the conferences held on August 26, 1942 and December 16, 1942.

A copy of this letter and statement has been mailed to your representative, Mr. Samuel Kaufman, First National Bank Building, Pittsburgh, Pennsylvania, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

ADJUSTMENTS TO NET INCOME

Net income as disclosed by return		$40,570.14
Unallowable Deductions and Additional Income:		
(a) Salary income increased	$2,048.26	
(b) Dividends increased	12,500.00	
(c) Partnership income increased	549.26	
(d) Legal fees decreased	4,500.00	
		19,597.52
Net income as adjusted		60,167.66

EXPLANATION OF ADJUSTMENTS

(a) It is held that the salary received by you from Crandall, McKenzie & Henderson, Inc. in the year 1940 in the amount of $6,750.00 is taxable to you in its entirety.

Salary reported on your income tax return	$4,701.74
Salary actually received in 1940	6,750.00
Net increase in salary reported	2,048.26

(b) It is also held that dividends received by you from Crandall, McKenzie & Henderson, Inc. in the amount of $12,500.00 in the year 1940 are one hundred percent taxable.

(c) Your share of the net income from the partnership firm of Sweet Clean-Perfect Laundries has been adjusted as follows:

Net income as disclosed by partnership return		$87,500.04
Unallowable deductions and additional income:		
(1) Loss on trade-in decreased	$545.00	
(2) Gifts decreased	553.52	
		1,098.52
Net income of partnership adjusted		88,598.56

Explanation of Adjustments

(1) The loss reported from the exchange of equipment has been disallowed in accordance with the provisions of Section 112 (b)–1, Internal Revenue Code.

Cost of old equipment	$1,800.00
Depreciation allowed	360.00
Depreciated value	1,440.00
Allowance on exchange	885.00
Loss claimed which has been disallowed	555.00

(2) The deduction claimed for gifts made during the year has been disallowed as not being an ordinary and necessary business expense within the provisions of Section 19.23 (a)–1 Internal Revenue Code.

Bonus paid Mr. Logan	$200.00
Candy for employees	353.52
Total	553.52

Your distributive share of the adjusted net income of the partnership is 50 percent or $44,299.28.

(d) It is further held that the amount of $4,500.00 deducted by you in your 1940 income tax return as legal fees represents a personal expenditure which may not be deducted in computing your net income for that year.

11 Computation of Tax

Net income adjusted	$60,167.66
Less: Personal exemption	2,000.00
Balance (surtax net income)	58,167.66
Less: Earned income credit (10% of $14,000.00)	1,400.00
Net income subject to normal tax	56,767.66
Normal tax at 4% on $56,767.66	2,270.71
Surtax on $58,167.66 (Amount in excess of $4,000.00)	15,373.77
Total tax (ordinary)	17,644.48
Defense tax (10% of $17,644.48)	1,764.45
Total income and defense taxes	19,408.93
Corrected tax liability	19,408.93
Income tax assessed: Original, account No. 2040029	9,812.60
Deficiency of income tax	9,596.33

NCD/MMM.

12 In the Tax Court of the United States

[File endorsement omitted]

Docket No. 1162

SIDNEY S. MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Answer

Filed May 15, 1943

Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition in the above-entitled proceeding admits and denies as follows:

1. Admits the allegations of paragraph 1 of the petition.

2. Admits the allegations of paragraph 2 of the petition.

3. Admits the allegations of paragraph 3 of the petition.

4. (a) Denies the allegations of paragraph 4 (a) of the petition. (b) Denies the allegations of paragraph 4 (b) of the petition. (c) Denies the allegations of paragraph 4 (c) of the petition. (d) Denies the allegations of paragraph 4 (d) of the petition.

5. (a) Admits the allegations of paragraph 5 (a) of the petition.

(b) Admits that in April, 1940, petitioner acquired by purchase shares of the capital stock of Crandall, McKenzie & Henderson, Inc., a Pennsylvania corporation; denies all other allegations of paragraph 5 (b) of the petition.

(c) Admits petitioner became an officer and employee of Crandall, McKenzie & Henderson, Inc., and in 1940 received
13 compensation for services rendered to the corporation; denies the remaining allegations of paragraph 5 (c) of the petition.

(d) Denies the allegations of paragraph 5 (d) of the petition.

(e) Denies the allegations of paragraph 5 (e) of the petition.

(f) Admits that subsequent to April, 1940, Crandall, McKenzie & Henderson, Inc., distributed to its stockholders cash in the amount of $1.25 per share; denies all other allegations of paragraph 5 (f) of the petition.

(g) Denies the allegations of paragraph 5 (g) of the petition.

6. Denies generally each and every allegation of the petition not hereinabove specifically admitted, qualified, or denied.

Wherefore, it is prayed that the petition be denied.

(Signed) J. B. Wenchel,
OB
J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
HARTFORD ALLEN,
Division Counsel,
J. HARRISON MILLER,
Special Attorney,
Bureau of Internal Revenue.
amh: 5/12/43.

14 In the Tax Court of the United States

[File endorsement omitted].

Docket No. 1162

SIDNEY S. MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 1163

CARL MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Stipulation of facts

Filed October 30, 1944

It is hereby stipulated and agreed by and between the parties hereto acting through the undersigned attorneys that for the purpose of trial and decision the following facts are true, without prejudice to the right of either party to introduce other and further evidence not inconsistent therewith.

1. On March 21, 1940 each of the above-named petitioners acquired by purchase at the price of $8.00 per share 10,000 shares of the common stock of Crandall-McKenzie & Henderson, Inc., a

Pennsylvania corporation, out of a total of 38,922 shares of capital stock of said corporation issued and outstanding (exclusive of 11,078 shares of treasury stock) at the price of $8.00 per share under the terms of a written agreement, copy of which is marked Exhibit 1-A and is offered in evidence.

2. On June 19, 1940, Crandall-McKenzie & Henderson, Inc., distributed to its common shareholders cash in the amount of $35,166.25 at the rate of $1.25 per share of which each petitioner received $12,500 with respect to the 10,000 shares held by him.

3. Crandall-McKenzie & Henderson, Inc., at December 31, 1939, had no earnings or profits accumulated from December 4, 1928 to December 31, 1939, and it had no earnings or profits in its taxable year January 1, 1940 to December 31, 1940.

4. Paragraphs 9 to 24, inclusive, of the findings of fact of Schoonmaker, J., in the actions in the District Court of the United States for the Western District of Pennsylvania at Nos. 7085 and 7086 Law, in which Jessie Lee Brown and A. J. Kapp are plaintiffs and D. D. Heiner was defendant are made part of this stipulation, reading as follows:

"9. On November 24, 1928, an agreement was entered into between O. McKenzie and L. Henderson, Jr., of the first part; and K. W. Todd & Company, of the second part, which is shown by Plaintiff's Exhibit I. This exhibit is made a part of these findings of fact.

"The agreement may be summarized as follows:

"Whereas: O. McKenzie owns 842½ shares of stock in Crandall-McKenzie Company, a New Jersey Corporation, which Company has a total authorized capital of $25,000 with 2,060 shares (par $10.00) outstanding.

"Whereas: L. Henderson, Jr., is the owner of, or can deliver, 700 shares (par $100.00) of the capital stock of L. Henderson & Sons, Incorporated, with an outstanding capital stock of 700 shares.

"Whereas: It is desired to consolidate Crandall-McKenzie Company and L. Henderson & Sons Company, Incorporated.

"Now this Agreement: Witnesseth that for and in consideration of mutual covenants herein contained, the parties hereto agree as follows:

"First: The parties of the first part (McKenzie and Henderson) agree to form a new company to be known as Crandall-McKenzie & Henderson, Incorporated (called "new company") with an authorized capital of 100,000 shares of common stock (no par value) of which 50,000 shares shall be immediately issued.

"Second: The party of the second part (K. W. Todd & Company) agrees to buy from said company 28,295 shares of its stock for $544,195.00.

"Third: The parties of the first part (McKenzie and Henderson) agree that they will cause the said corporation to exchange with said O. McKenzie 12,181 shares of its said stock for 842½ shares of the stock of Crandall-McKenzie Company and further agree that they will cause said new company to exchange with L. Henderson, Jr., 9,524 shares of its stock for 700 shares of the stock of L. Henderson & Sons Company, Incorporated.

"Fourth: The parties of the first part (McKenzie and Henderson) agree that they will cause A. E. Crandall to sell to Crandall-McKenzie & Henderson, Incorporated, and will cause Crandall-McKenzie and Henderson, Incorporated, to purchase from A. E. Crandall, 842½ shares of the capital stock of Crandall-McKenzie Company for the sum of $300,000.00 (cash) and that they
17 will cause the other stockholders of Crandall-McKenzie Company to sell to Crandall-McKenzie & Henderson, Incorporated, and will cause said Crandall-McKenzie & Henderson, Incorporated, to buy from the said other stockholders at $315.53 (cash) per share, sufficient stock of said Crandall-McKenzie Company so that together with the stock which it will acquire from the said O. McKenzie and said A. E. Crandall, said Crandall-McKenzie & Henderson, Incorporated, will not own less than 90% of the outstanding stock of said Crandall-McKenzie Company.

"Fifth: That the said Crandall-McKenzie & Henderson, Incorporated, as a stockholder, will cause Crandall-McKenzie Company and L. Henderson & Sons Company, Incorporated, to liquidate and distribute all assets to the new company.

"Sixth: The party of the second part (K. W. Todd & Company) is not obligated to make the purchase of 28,286 shares of the new company unless the parties of the first part carry out the agreements stated above.

"10. At the time of the making of the above agreement on November 24, 1928, the capital stock of L. Henderson and Sons Company, Inc., and of Crandall-McKenzie Company was respectively held as follows:

L. Henderson & Sons, Co., Inc.

L. Henderson, Sr.	532 shares
L. Henderson, Jr.	105 shares
V. E. Martin	10 shares
J. T. Henderson	51 shares
D. Henderson	1 share
T. R. Henderson	1 share
	700 shares

CRANDALL-MCKENZIE COMPANY

O. McKenzie	812½ shares
A. E. Crandall	812½ shares
A. J. Kapp	100 shares
J. L. Brown	100 shares
L. A. Ayers	20 shares
Geo. Hasson	5 shares
104 stockholders	150 shares
	2,000 shares

18 "11. A. E. Crandall noted above as owning 812½ shares of the Crandall-McKenzie Company, opposed the consolidation and would not sell his stock to the new company. Neither would he exchange his stock for stock of the new company. But he did finally sell his 812½ shares to O. McKenzie for $500,000.00 in cash.

"12. After the purchase from A. E. Crandall, the stockholders of Crandall-McKenzie Company were as follows:

O. McKenzie	1,685 shares
A. J. Kapp	100 shares
J. L. Brown	100 shares
L. A. Ayers	20 shares
Geo. Hasson	5 shares
104 stockholders	150 shares
Total	2,060 shares

"13. The new company, Crandall-McKenzie & Henderson, Inc., was organized and charter granted. The first meeting of the stockholders was held on December 4, 1928, at 9:30 A. M. The capital of the new company at this time was $5,000, consisting of 50 shares of a par value of $100 each. 5 shares had been issued to the incorporators. At subsequent meetings of the stockholders and directors held the same day, the capital was increased to $100,000, consisting of 1,000 shares of a par value of $100 each, and then changed to 100,000 shares of no par common with a stated value of $100,000.

"14. At a special meeting held at noon on December 4, 1928, the directors of the new company having been authorized by the stockholders at a meeting held at 11:30 A. M., passed the following resolutions:

"1. That the company purchase from O. McKenzie 1,685 shares of the stock of Crandall-McKenzie Company and pay him therefor $380,000.00 in cash and 12,181 shares of the capital stock of the company.

"2. That the proper officers of the company issue to O. McKenzie in part payment for said stock of Crandall-McKenzie Company, 12,181 fully paid and nonassessable shares of the capital stock of the new company.

"3. That the officers of the company purchase as many of the other shares of Crandall-McKenzie Company as possible, paying therefor $315.53 per share in cash.

19 "4. That 9,524 shares of the capital stock of the new company be issued in payment for 700 shares of the capital stock of L. Henderson & Sons Company, Inc.

"5. That the company sell to K. W. Todd & Company 27,795 shares of the capital stock of the company for $544,195.00, payable in cash.

"15. These resolutions called for the issuance of 49,500 shares of no par common stock of the new company as follows:

Shares to O. McKenzie in part payment of purchase of Crandall-McKenzie Company stock	12,181
Shares to acquire 700 (all) shares of L. Henderson & Sons Company, Incorporated	9,524
Shares sold to K. W. Todd Company	27,795
	49,500
Shares held by incorporators	500
Shares—Total authorized issue	50,000

"16. The agreement outlined above required the acquisition of not less than 90% of the stock of Crandall-McKenzie Company. The 1,685 shares purchased from O. McKenzie (his "original" stock and that which he acquired from A. E. Crandall) constituted less than ninety per cent. But resolution No. "3" gave the directors of the new company power to acquire further shares necessary to make up the ninety per cent. After the above five resolutions were passed, the chairman of the meeting stated that the company could acquire from O. McKenzie and other stockholders (names not mentioned), 1,910 shares of Crandall-McKenzie Company stock. This would mean the acquisition of 225 shares over and above the 1,685 already owned by the new company. These shares were purchased from K. W. Todd & Company at $315.53.

"17. The Board of Directors passed the following resolutions:

"Resolved: That this Company vote its stock of Crandall-McKenzie Company in favor of the dissolution of such company and to that end the proper officers of this company are hereby authorized and directed to execute a proxy for all of the stock of Crandall-McKenzie Company owned by this company to be used at a special meeting of the stockholders of the Crandall-McKenzie Company called for the purpose of approval or disapproval of the dissolution of such company.

20 "Resolved: That this company purchase from the liquidating trustees of Crandall-McKenzie Company all of the assets of Crandall-McKenzie Company, including its real estate plant and equipment, its good will and all of its other personal property and pay for the same the sum of $649,991.80, paying $602,662.30 by the delivery of the 1,910 shares of the capital stock of Crandall-McKenzie stock and the balance, $47,329.50, in cash

upon receipt of proper deeds, bills of sale and other instruments transferring all of said assets to this company.

"18. December 14, 1928, was fixed as the date of completion of all of the above transactions.

"19. At the same meeting, O. McKenzie became president of the new company, and J. L. Brown, treasurer. Other officers and directors were also elected.

"20. On December 5, 1928, the directors of the Crandall-McKenzie Company voted to dissolve and ordered a stockholders' meeting to be held for that purpose on December 17, 1928, in the office of the company at Camden, New Jersey. Subsequently, the directors voted to sell the assets of the company to Crandall-McKenzie & Henderson, Inc., (the new company) for $649,991.80, consisting of 1910 shares of Crandall-McKenzie Company stock and $47,329.50 in cash. The new company was to assume all the liabilities of the old company. All of the cash to be received from the new company was to be distributed to the holders of the remaining outstanding shares of the Crandall-McKenzie Company.

"21. Pursuant to these resolutions the assets and liabilities of Crandall-McKenzie Company were transferred to the new company and the latter surrendered 1910 shares of Crandall-McKenzie stock, and paid $47,329.50 to the Diamond National Bank of Pittsburgh as trustee for the Crandall-McKenzie Company. This $47,329.50 was paid to the remaining stockholders of Crandall-McKenzie Company who owned the remaining 150 outstanding shares.

"22. The stock of L. Henderson & Company was also acquired as called for in the group of five resolutions above set forth (passed at the special meeting of December 4, 1928, supra). That is, the new company issued 9,524 shares of its capital stock in payment for all outstanding shares—700—of the capital stock of L. Henderson & Sons Company, Inc. The latter company then transferred its assets and liabilities in liquidation to the new company and the latter surrendered to L. Henderson & Sons Company the 700 shares capital stock of the latter. This completed the reorganization.

"23. The 100 shares of capital stock of the Crandall-McKenzie Company owned by each plaintiff were transferred by him through K. W. Todd & Company in exchange for 1213 shares of the new company and $15.00 in cash.

"24. The plan of reorganization, as originally adopted, was modified so as to provide for the exchange of the 100 shares of stock owned by each plaintiff in Crandall-McKenzie Company for stock in the new company and each of them became an officer or employee of the new company."

22 5. K. W. Todd & Company was at the times of the foregoing transactions engaged in the investment banking and brokerage business in the City of Pittsburgh, Pennsylvania and purchased the shares of Crandall-McKenzie & Henderson, Inc., in the regular course of business.

6. The 50,000 shares of common stock of Crandall-McKenzie & Henderson, Inc., issued by it in December 1928 were upon consummation of the December, 1928 transactions held by the following persons for the named considerations:

No. of Shares	*Shareholder*	*Consideration*
12,181	O. McKenzie	842½ shares Crandall-McKenzie.
1,213	J. L. Brown	100 shares Crandall-McKenzie.
1,213	A. J. Kapp	100 shares Crandall-McKenzie.
9,524	L. Henderson & Associates	700 shares L. Henderson, Inc.
500	Incorporaters	Cash.
25,369	K. W. Todd & Co.	Cash.
50,000		

7. Crandall-McKenzie & Henderson, Inc., at no time after its organization issued any capital shares other than the 50,000 shares of common stock issued in December 1928 and the stated value of the shares was at all times $1.00 per share.

8. At the time of the transfer of its assets in December 1928 to Crandall-McKenzie & Henderson, Inc., Crandall-McKenzie Company had accumulated earnings or profits of $345,298.49 and
23 at March 1, 1913 it had accumulated earnings or profits of $16,030.54.

9. At the time of the transfer in December 1928 of its assets to Crandall-McKenzie & Henderson, Inc., L. Henderson & Sons, Inc., had accumulated earnings and profits of $74,743.62 which were accumulated after March 1, 1913.

10. From December 4, 1928, the date of its organization, to December 31, 1939 Crandall-McKenzie & Henderson, Inc., had aggregate earnings and profits of $401,470.07, made aggregate cash distributions to shareholders of $369,452.30, and acquired by purchase for cash 11,078 shares $1.00 par value of its own stock for $72,211.13. In 1940 it had a net loss of $37,252.47 and acquired by purchase for cash 12,805 shares $1.00 par value of its own stock for $94,441.90.

11. Petitioner at Docket No. 1162 concedes issues 4 (a) and (d), and petitioner at Docket No. 1163 concedes issue 4 (c).

SAMUEL KAUFMAN,
Counsel for Petitioners.

(Signed) J. P. Wenchel.
JHM
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Counsel for Respondent.

24 *Joint Exhibit 1–A*

AGREEMENT

Dated March 21, 1940, Between O. McKENZIE and SIDNEY S. and CARL P. MUNTER

25 THIS AGREEMENT

Made this 21st day of March 1940, by and between O. McKenzie, of the City of Pittsburgh in the County of Allegheny in the Commonwealth of Pennsylvania (hereinafter sometimes referred to as "McKenzie"), of the one part and Sidney S. Munter and Carl P. Munter, of the same place (hereinafter sometimes collectively referred to as the "Munters"), of the other part.

Witnesseth that:

1. McKenzie agrees simultaneously with the execution and delivery hereof, to sell and deliver to Munters 20,000 shares of the common stock without par value of Crandall-McKenzie & Henderson, Incorporated, a Pennsylvania corporation (hereinafter sometimes referred to as the "corporation"), owned by McKenzie (being a majority of the shares of stock of the corporation issued and outstanding excluding shares of stock issued and outstanding but owned by the corporation and held in its treasury) at the price of $8.00 per share; and Munters agree to buy all said shares and forthwith to pay the sum of $160,000.00 therefor upon delivery by McKenzie to or to the order of Munters of share certificates evidencing McKenzie's ownership of said shares, properly endorsed and stamped for transfer.

2. Munters agree that they will, on the same basis as to payments in installments and otherwise as is provided in paragraph 5 hereof in respect of minority holders, as therein defined, purchase of McKenzie the remaining 2,491 shares of the
26 common stock of the corporation owned by McKenzie, at the price of $8.00 per share (adjusted by pro rata decrease or increase in the event of the dilution or concentration, respectively, of the equity represented by said shares), and McKenzie agrees to sell said shares to Munters at said price, and on such basis; provided, however, that if the corporation shall, before said purchase and payment in full of the purchase price, make any money distribution to its shareholders (including McKenzie) in respect of its outstanding common shares, Munters shall be entitled to a credit against the price of $8.00 per share (adjusted as aforesaid) equal to the amount per share actually paid to McKenzie in respect of each such share on account of such money distribution.

3. Munters agree that the corporation and/or Munters will, in a manner satisfactory to McKenzie, purchase at the price of $8.00 per share (adjusted as set forth in paragraph 2 hereof) such of the outstanding 16,431 shares of the common stock of the corporation (which 16,431 shares are hereinafter sometimes referred to as "minority shares," and are all the shares of stock of the corporation issued and outstanding after excluding (a) 11,078 shares of the common stock of the corporation issued and outstanding, owned by the corporation and held in its treasury, and (b) the 22,491 shares of said stock owned by McKenzie and referred to in paragraphs 1 and 2 hereof) as may be offered to it by the holders thereof of record as of March 15, 1940, or the heirs, executors, administrators or trustees of any deceased holder of record as of said date; provided, however, that this agreement shall not inure to the benefit of any person in respect of any minority shares of which he became the record holder after March 15, 1940, unless such new record ownership occurred proximately by reason of inheritance, bequest, or distribution from a decedent who was such record holder on or prior to March 15, 1940; and provided further that if the corporation shall, before said purchase or after said purchase but before payment in full of the purchase price, make any money distribution to its shareholders in respect of its outstanding common shares, the corporation and/or Munters shall be entitled to a credit against the price of $8.00 per share (adjusted as aforesaid) equal to the amount per share actually paid to the offering shareholder in respect of the shares offered, on account of such money distribution; and Munters agree that the corporation, or they, will purchase and pay for all such shares as shall be offered to it or them for purchase on terms determined as hereinbelow set forth, by record holders as of March 15, 1940, and heirs, executors, administrators and trustees, as above set forth, and that if the corporation shall for any reason whatsoever not do so, they, Munters, will. In order that this agreement may effectively inure to the benefit of such record holders of said 16,431 shares, their heirs, executors, administrators and trustees (who, including such heirs, executors, administrators, and trustees, are hereinafter sometimes collectively referred to as the "minority holders"), Munters agree that the corporation, or they, will on or before April 15, 1940, send to each of the minority holders, by first-class mail, postage prepaid, addressed to each such holder at his last known address as shown on the records of the corporation, and to the Secretary of the Pittsburgh Stock Exchange for the benefit of all such holders, a written or printed offer, in form satisfactory to McKenzie and sufficient, if and to the extent accepted, as will be specified in the offer, to constitute an obligation legally enforceable by each such minority holder

to the extent of his own interest by action brought either
28 in his own name or in the name of McKenzie to his use, to purchase all or any part of such minority shares at such price, and to pay for same in installments, in amounts, at times, and under terms and conditions, satisfactory to McKenzie, at least one-half of said price to be paid on or before January 1, 1941, and the final installment to be paid not later than January 1, 1942. The agreements by Munters expressed in this paragraph are made by Munters with McKenzie acting as the agent on this behalf of the minority holders, and for and on behalf of such minority holders and for their use and benefit, to the end, understood and intended by Munters, who also intend to be legally bound by the provisions of this paragraph and of said offer, that the same shall constitute an obligation to such of the minority holders as desire to avail themselves of the benefits thereof, legally enforceable by each such minority holder to the extent of his own interest, by action brought either in his own name or in the name of McKenzie to his use.

4. Munters agree that the corporation shall forthwith enter into an agreement with McKenzie whereby

(a) In consideration of an agreement by McKenzie that, for a period of five (5) years from April 1, 1940, or for the remainder of his life (whichever shall be the shorter period) he will, subject to other business and personal demands on his time, act as technical and business consultant for the corporation; provided, however, that nothing herein contained shall oblige McKenzie to be available for consultation at any particular time or times or during any particular part or parts of the period of
29 his said retainer; and provided further that, recognizing the corporation's continued right to the use of its present corporate name, the corporation will use the name "O. McKenzie", or "Orel McKenzie" in advertising and business solicitation and otherwise publicize and make use of McKenzie's connection with the corporation, only in ways and by means in each case submitted to and approved by McKenzie in advance of such use and/or publicity; and

(b) In further consideration of a covenant by McKenzie that he will not, at any place within the Commonwealth of Pennsylvania, directly or indirectly, as sole proprietor, partner, minority or majority stockholder, technical consultant (for any person, firm or corporation other than the corporation), officer, manager, employee, or in any other manner, or to any other extent, engage in the cleaning or dyeing business, or in any kind of business engaged in by the corporation on or prior to July 20, 1939, nor suffer nor permit the use of his name in connection with any such business; provided, however, that he may, without limitation, under

any trade name or corporate title not containing the name "McKenzie", engage in the business of the manufacture and/or sale of materials and supplies of the kinds used by the cleaning and dyeing industry and similar industries, and to the extent by him considered necessary or advantageous, publicize his connection with such business; the corporation will (by an agreement satisfactory to McKenzie in form and authorization) agree to, and will, pay to McKenzie the sum of $45,000.00, payable $9,000.00 on December 31, 1940, and $9,000.00 on December 31st of each year thereafter down to and including December 31, 1944, provided, however, that if McKenzie should die prior to December 31, 1944, all sums thereafter payable hereunder shall be paid by the corporation to McKenzie's estate, as and when said sums shall be due and payable as above specified. McKenzie for his own part agrees that he will enter into the agreement with the corporation contemplated by clause (a) of this paragraph 4, and the covenant contemplated by clause (b) of this paragraph 4, and, for the consideration hereinabove expressed, that he will in good faith perform and comply with said agreement and said covenant, and will act as technical and business consultant at all times when he is available, and that he will not act as technical or business consultant for any person, firm or corporation other than the corporation. Munters agree that the obligation of the corporation to McKenzie under said agreement shall be evidenced and secured by a separate written obligation of the corporation, supported by valid corporate authorization satisfactory to McKenzie, which obligation shall be endorsed or guaranteed by Munters in form satisfactory to McKenzie.

5. All Munter's agreements hereinabove contained for certain covenants, agreements and other things to be made, performed and done by the corporation shall be construed as importing an obligation upon Munters, and Munters hereby oblige themselves, to use every proper and legal means at their disposal, (including without limitation, control by executive management and/or by majority stock ownership in their own names and/or the names of their nominees) to induce the corporation to make, perform and do such covenants, agreements and other things. And Munters hereby agree that if the corporation shall be unable, or shall fail, neglect or refuse, to pay any money, or to agree to do, or to do, any other act or thing, hereinabove stipulated to be paid, or agreed to be done, or done, by the corporation, or shall be restrained from so paying, agreeing or doing, they, Munters, will pay said sum or sums of money, and agree to do, and do, such acts and things, at the respective times hereinabove stipulated as to the corporation, for Munters' own account and at their own expense.

6. All obligations by Munters in this agreement contained or referred to are intended by Munters, and shall be understood and construed to be, the obligations of Sidney S. Munter and Carl P. Munter, jointly and severally. All benefits and obligations conferred and imposed upon the parties hereto, or upon the corporation, by this agreement, or herein referred to, are intended by the parties hereto, and shall be understood and construed to be, conferred and imposed upon the parties hereto and upon the respective heirs, executors and administrators, and, in respect of the corporation, upon the corporation and upon its successors and assigns. Each of the parties to this agreement intends to be legally bound by each and every of the provisions of this agreement.

In witness whereof, the parties hereto have hereunto respectively set their hands and seals, at Pittsburgh, Pennsylvania, the day and year first above written.

Witness:

RALPH D. FRANK [SEAL] O. McKENZIE.
SAMUEL KAUFMAN O. McKENZIE.
of the one part.

DAVID GLICK [SEAL] Sidney S. Munter,
SIDNEY S. MUNTER.

DAVID GLICK [SEAL] Carl P. Munter,
CARL P. MUNTER.
both of the other part.

32 COMMONWEALTH OF PENNSYLVANIA,
County of Allegheny, ss:

On this 21st day of March A. D. 1940, before me, the undersigned authority, came the above named O. McKenzie, and acknowledged the foregoing Agreement to be his act and deed, to the intents and purposes therein expressed.

Witness my hand and notarial seal, the day and year aforesaid.

KATHERINE HARVEY,
Notary Public.

COMMONWEALTH OF PENNSYLVANIA,
County of Allegheny, ss:

On this 21st day of March, A. D. 1940, before me, the undersigned authority, came the above named Sidney S. Munter and Carl P. Munter, and severally acknowledged the foregoing Agreement to be their act and deed, to the intents and purposes therein expressed.

Witness my hand and notarial seal, the day and year aforesaid.

KATHERINE HARVEY,
Notary Public.

33 In the Tax Court of the United States

5 T. C. No. 12

Docket Nos. 1162 1163—Promulgated May 22, 1945

SIDNEY S. MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

CARL MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

C corporation, organized to acquire the assets of corporations A and B, under a plan of reorganization, acquired such assets in December 1928 for 24,131 shares of the capital stock of C and $355,247.75 in cash, which was received by shareholders of A and B in exchange for such stock. The remaining stock of C, constituting more than 50 percent of its entire issued stock, was, under the plan, acquired by new interests for cash in the sum of approximately $486,893.92. Included in the assets acquired from A and B were earnings and profits of those corporations in the sum of $404,011.57 accumulated subsequent to March 1, 1913. In 1940 C distributed to petitioners, as stockholders, cash at the rate of $1.25 per share. As of that date and since its organization C had sustained losses, distributed ordinary dividends, and liquidated or purchased outstanding stock for amounts exceeding the par value of that stock, in such an aggregate sum as to leave an amount in its total earnings and profits for that period
34 insufficient to cover the contested dividends. Held, that the distribution to petitioners in 1940 was from earnings and profits of C and was therefore taxable to petitioners as an ordinary dividend. Commissioner v. Sansome, 60 Fed. (2d) 931; cert. den., 287 U. S. 667.

Samuel Kaufman, Esq., for the petitioners.

Homer F. Benson, Esq., for the respondent.

Opinion

LEECH, Judge: These consolidated proceedings involve deficiencies in income taxes for the calendar year 1940 in the sum of $9,596.33 in the case of petitioner, Sidney S. Munter, and $8,175.50 in the case of petitioner, Carl Munter. The question in each proceeding is whether distributions in the taxable year by Crandall-McKenzie & Henderson, Inc., to the petitioners as stockholders were from earnings accumulated subsequent to March 1, 1913, and

taxable as ordinary dividends, or were returns of capital. The Federal income tax returns of the petitioners for the taxable year were filed with the collector for the 23rd district of Pennsylvania at Pittsburgh, Pennsylvania. The proceedings were submitted upon a formal stipulation of facts which we include herein by reference as our findings of fact.

Briefly stated, the facts are that on March 31, 1940 each of the petitioners, at the price of $8 per share, purchased 10,000 shares of the common stock of Crandall-McKenzie & Henderson, Inc. (hereinafter referred to as "Crandall-McKenzie"), a Pennsylvania corporation, out of a total of 38,922 shares of its capital stock issued and outstanding (exclusive of 11,078 shares of treasury stock). On June 19, 1940, Crandall-McKenzie distributed to its common shareholders cash in the amount of $35,166.25 at the rate of $1.25 per share, of which each petitioner received $12,500 with respect to the 10,000 shares held by him. Crandall-McKenzie, at December 31, 1939, had no earnings or profits accumulated from December 4, 1928, to December 31, 1939, and it had no earnings or profits in the calendar year 1940.

Pursuant to an agreement between K. W. Tood & Company, investment bankers, O. McKenzie and L. Henderson, shareholders of two predecessor corporations, Crandall-McKenzie Company and L. Henderson & Sons, Inc., Crandall-McKenzie had been formed in December 1928 and had acquired all the assets of the two named predecessor corporations in exchange for 24,131 shares of its capital stock and $355,247.75 in cash. This stock and cash were received by stockholders of the two predecessor companies for their stock therein. The remaining 25,869 shares in the new company were issued to new interests for cash in the amount of approximately $486,893.92.

All of the assets of one of the predecessor corporations, L. Henderson & Sons, Inc., were acquired by Crandall-McKenzie solely in exchange for 9524 shares of its stock. At the time of this acquisition L. Henderson & Sons, Inc., had earnings and profits of $74,743.62 accumulated subsequent to March 1, 1913.

The assets of the other predecessor corporation, Crandall-McKenzie Company, were acquired by the new company, Crandall-McKenzie, for 14,607 shares of its stock and $355,247.75 in cash. At the time of this transaction, Crandall-McKenzie Company had earnings and profits accumulated subsequent to March 1, 1913 in the amount of $329,267.95.

O. McKenzie owned 842½ of the outstanding 2,000 shares of stock in Crandall-McKenzie Company, and A. E. Crandall owned the same number of shares. The agreement provided that O. McKenzie and L. Henderson would "cause A. E. Crandall to sell to Crandall-McKenzie * * * [his] 842½ shares.

* * * for * * * $300,000". Crandall refused, however, to go along with the plan or sell to Crandall-McKenzie, but he did sell his stock to O. McKenzie for $300,000. Crandall-McKenzie then purchased, as a block of 1,685 shares, this stock together with the 842½ shares which O. McKenzie owned originally, from O. McKenzie for $300,000 and 12,181 shares of Crandall-McKenzie stock.

From December 4, 1928, the date of its organization, to December 31, 1939, Crandall-McKenzie had aggregate earnings and profits of $401,470.07. During the same period it made aggregate cash distributions of $369,452.30 to shareholders and liquidated or purchased 11,978 shares of its own $1 par value stock for $72,211.13 in cash. In 1940 it had a net loss of $37,252.47 and liquidated or purchased 12,805 shares of its own $1 par value stock for $94,441.90 in cash.[1]

Respondent has treated the distributions to the two petitioners in 1940 as if made from earnings and profits accumulated subsequent to March 1, 1913 and, consequently, taxable as a dividend. The petitioners contend that Crandall-McKenzie, the distributing corporation, at the time of the distributions had no accumulated earnings and profits and that accordingly the distribution was made from capital and not subject to tax. The issue is resolved upon the determination of one question, to wit: whether the distributing corporation, upon its organization in 1928, in the transaction in which it acquired the assets of the two predecessor corporations for stock and cash, took the accumulated earnings and profits of those corporations as its earnings and profits.

In the transaction of December 1928, Crandall-McKenzie, the new company, acquired all the assets of the two predecessor corporations. Stockholders of those two corporations continued as stockholders of the new company and held upwards of 45 per cent of its stock. Under such circumstances we think it is clear that transaction constituted a reorganization under section 112 (i) (1) (A) of the controlling Revenue Act of 1928. Helvering v. Minnesota Tea Co., 296 U. S. 378; John A. Nelson Co. v. Helvering, 296 U. S. 374; Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U. S. 462. In pursuance of the plan, which included that reorganization, the participating stockholders of the old corporations exchanged their stock in the old corporations for stock in the new company and money. These exchanges, therefore, were undoubtedly within the provisions of sections 112 (b) (3) and

[1] Whether the liquidation or purchase of its shares or the net loss did, in fact, reduce earnings and profits available for the payment of the contested dividends we do not consider because, assuming they did not, Crandall-McKenzie did not have enough earnings and profits, earned since its organization, to completely cover the disputed dividends.

112 (c) (1) of the Revenue Act of 1928, as was decided by the United States District Court for the Western District of Pennsylvania in the cases of Brown v. Heiner and Kapp v. Heiner, 15 A. F. T. R. 899. Both parties apparently accept that premise. Respondent argues then that the rules of Commissioner v. Sansome, 60 Fed. (2d) 931; cert. den., 287 U. S. 667, applies
38 and that the earnings and profits of the two predecessor companies retained the status of earnings and profits in the hands of Crandall-McKenzie, the new company.

In the Sansome case the assets of the predecessor corporation were acquired solely for all of the stock in the new corporation which was issued to the stockholders of the old corporation in the same proportions in which they held the stock of the original company. It was there held that the earnings and profits of the old corporation retained the character of earnings and profits in the hands of the new corporation. Petitioners insist that the Sansome rule must be limited to its precise facts, that the situation in connection with the acquisition of the assets of the two predecessor corporations here by Crandall-McKenzie is different from that in the Sansome case in two respects, and that these differences compel the opposite conclusion to that of the court in the Sansome case. Thus petitioners argue (1) that the new capital which came into the new corporation substantially changed the proportionate stockholdings of the old shareholders and thus the identity of the predecessor corporations, and (2) that this new capital was used to acquire a large amount of stock of such corporations at a premium, thus effecting a distribution of the earnings and profits of the predecessor corporations. They rely wholly on Milton Campbell et al. v. United States, 144 Fed. (2d) 177. In that case a successor corporation acquired the business and assets of two pred-
ecessor companies in 1929 in a reorganization under sec-
39 tion 112 (i) (1) (A) of the Revenue Act of 1928, pursuant to which the old stockholders received in exchange stock in the new corporation in a reduced proportional interest and cash, the proceeds of the sale of some of its stock to outsiders by the new corporation.[2] At the time of this reorganization the two predecessor companies had undistributed profits accumulated since February 28, 1913. In 1933 and 1934, the new corporation paid dividends to its preferred stockholders which were substantially more than the earnings of the new company from the date of its incorporation to the date of those distributions. Both of the petitioners were stockholders in the new company, the one having acquired his stock in the 1929 reorganization and the other having

[2] The reorganization in the present case is controlled by the same Revenue Act, to wit: the Revenue Act of 1928.

purchased her stock thereafter. The Circuit Court of Appeals for the Third Circuit, to which this proceeding may be appealed, held that the Sansome rule was not applicable for two reasons: (1)

The identity of proprietary interests which existed in the Sansome case and motivated the court to disregard the corporate entities and treat the earnings of the predecessor corporation as though they were earnings of the successor corporation is, therefore, completely lacking. We think that for this reason alone the doctrine of the Sansome case, which by judicial construction operates to transfer earnings from the corporation which earned them to its successor in reorganization, is inapplicable."

and (2)

"The doctrine of the Sansome case that the accumulated earnings of the predecessor corporation in a tax-free reorganization shall be deemed carried over to the successor corporation for the purpose of distribution to its stockholders as dividends cannot apply to a situation where the accumulated earnings of the predecessor corporation have been distributed to its stockholders at the time of the reorganization. Obviously earnings cannot at one and the same time be distributed to the stockholders of the predecessor corporation and transferred to the successor corporation. We think that in the present cases it must be held that the accumulated earnings of the old Company and of Mulford were distributed to the stockholders of the old companies. Such a conclusion is called for by a provision of the Revenue Act of 1928 which was in force when the reorganization took place.

Section 112 (c) of that Act provided:

"(c) Gain from Exchanges not Solely in Kind. (1) If an exchange would be within the provisions of subsection (b) (1), (2), (3), or (5) of this section if it were not for the fact that the property received in exchange consists not only of property permitted by such paragraph to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

"(2) If a distribution made in pursuance of a plan of reorganization is within the provisions of paragraph (1) of this subsection but has the effect of the distribution of a taxable dividend, then there shall be taxed as a dividend to each distributee such an amount of the gain recognized under paragraph (1) as is not in excess of his ratable share of the undistributed earnings and profits of the corporation accumulated after February 28, 1913. The remainder, if any, of the gain recognized under paragraph (1) shall be taxed as a gain from the exchange of property."

As we have already pointed out the reorganization involved the receipt by the stockholders of the Old Company and Mulford of money which under the facts was taxable to them under Section 112 (c). In each case the distribution exceeded the total accumulated earnings of the old companies. If this distribution had "the effect of the distribution of a taxable dividend" within the meaning of paragraph (2) of Section 112 (c) it must be treated as in law a distribution to the stockholders of the entire amount of those earnings.

As we have seen, the accumulated earnings of the Old Company amounted to $2,801,117.15. Since cash in the amount of $9,798,062.50 was distributed to the then common stockholders of the Old Company the distribution was a taxable dividend to the full extent of the accumulated earnings. The same is true of the distribution to the stockholders of Mulford. That company had accumulated earnings of $1,718,397.52 and the distribution amounted to $3,709,003.50 in cash.

Despite the respect in which we hold the Third Circuit Court of Appeals, we think the first reason upon which the Campbell case rests is unsound. See Helen V. Crocker, 29 B. T. A. 773. The identity of the interests of the shareholders of the predecessor corporation in the succeeding company was not, in our opinion, the basis for the decision in the Sansome case. The shareholders of the old corporation received nothing there but stock in the new company. Thus no taxable gain or recognized loss in the reorganization occurred under section 202 (c) (2) of the Revenue Act of 1924, there applicable. That, it seems to us, was the basis for the Sansome rule.

In attacking the validity of this reason supporting the opinion of the majority, in his dissent in the Campbell case Judge Jones said:

In so deciding [the Sansome case], Judge Learned Hand, who spoke for the Court, said (p. 933) that "what was not 'recognized' as a sale or disposition for the purpose of fixing gain or loss [i. e., the reorganization exchange], should [not] be 'recognized' as changing accumulated profits into capital * * *." As it was the intent of Congress, as evidenced by the Revenue Acts, to tax as dividends corporate distributions of earnings accumulated since February 28, 1913, manifestly, to accord such distributions freedom from taxation, when ultimately received by stockholders, merely because of coincidental bookkeeping attendant upon a successor corporation's acquisition of a predecessor's business and assets as the result of a reorganization, would be violative of the Congressional intent. It necessarily followed, therefore, as a corollary, that the nonrecognition of gain or loss allowed by the re-

organization provision there involved (Sec. 202 (c) (2) of
42 the Revenue Act of 1921) should, in the words of Judge Hand, "be read as a gloss upon section 201" (the taxable dividend definition of the Revenue Act of 1921). Accordingly, it was held in the Sansome case (p. 933), as a matter of statutory construction, "that a corporate reorganization which results in no 'gain or loss' under section 202 (c) (2) (42 Stat. 230) does not toll the company's life as continued venture under section 201, and that what were 'earnings or profits' of the original, or subsidiary, company, remain, for purposes of distribution, 'earnings or profits' of the successor, or parent, in liquidation." The same can be no less true as to a distribution in ordinary course. Sec. 112 (b) and (c) (1) of the Revenue Act of 1928 and Sec. 115 of the Revenue Acts of 1932 and 1934 here involved are substantially the same as the cognate provisions of the Revenue Act of 1921 dealt with in the Sansome case.

We agree with that expression. Compare Commissioner v. Wheeler et al., Exrs., — U. S. —, (Mar. 26, 1945).[3]

As to the second ground for the decision in the Campbell case, assuming it be sound, no basis of fact supporting it exists here. It is obvious, as the Circuit Court recognized in the case, that there could be no distribution having "the effect of the distribution of a taxable dividend" within the meaning of section 112 (c) (2) unless gain to the stockholder receiving that distribution in the exchange was recognizable under section 112 (c) (1).[4]
43 Love v. Commissioner, 113 Fed. (2d) 236; Estate of Edward T. Bedford, 1 T. C. 478; revsd. on another point, 144 Fed. (2d) 272; (cert. granted).

The record in the present case is wholly lacking, at least, in proof of the cost or basis for any of the stock in the predecessor companies in the hands of the exchanging stockholders of those companies. And without that fact there could be no determination of such gain under section 112 (c) (1). This is so unless the acquisition of the Crandall stock is treated as having been purchased by McKenzie for $300,000 and turned over for the same amount to the new corporation in a transaction separate from that involving his original stock—in which event there would have been no gain.

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[3] The Supreme Court there held that, under section 112 (b) (7) of the Revenue Act of 1938, where a corporation disposed of property acquired by it in a nontaxable exchange for its stock, the basis for determining "earnings and profits" available for distribution is the cost of the property to the transferors. Inter alia, the court there said:

"Congress has determined that in certain types of transaction the economic changes are not definitive enough to be given tax consequences, and has clearly provided that gains and losses on such transactions shall not be recognized for income tax liability but shall be taken account of later. §§ 112, 113. It is sensible to carry through the theory in determining the tax effect of such transactions on earnings and profits. Compare Commissioner v. Sansome, 60 F. 2d 931, and see Sen. Rep. No. 2156, 74th Cong., 2d sess., p. 19; H. R. Rep. No. 2894, 76th Cong., 3d sess., p. 41."

[4] In Knapp-Monarch Co., 1 T. C. 59, the fact of gain was apparently assumed, or at least the question was not raised.

Accordingly, we follow the rule announced in the Sansome case [5] and find that the earnings and profits of the predecessor corporations were taken over in toto by Crandall-McKenzie, the successor company. From this conclusion it follows that Crandall-McKenzie had sufficient earnings and profits to cover the distribution in question which was therefore, as the respondent determined, an ordinary dividend as to petitioners and taxable as such.

Reviewed by the Court.

Decisions will be entered for the respondent.

Dissenting opinion

44 DISNEY, J., dissenting: The only question here is whether the corporate distributions to petitioners were from capital or from earnings and profits. The majority opinion relies upon the Sansome case to establish earnings and profits in the distributing corporation. That case was one wherein the court pointed out that there was mere change of stock for assets, without change in proportion of stock holdings, and no other change in the financial structure. The conclusion there reached, that earnings and profits of the old corporation belonged to the new, is by the majority opinion here applied to a situation where more than 50 percent of the capital in the new corporation comes from sources foreign to the old and where, in addition to the exchange of stock for assets, cash is paid as to the predecessor corporation, Crandall-McKenzie, in an amount greater than its accumulated earnings and profits, and somewhat less than the accumulated earnings and profits of both corporations. Such a change in the corporate financial structure seems altogether sufficient to require distinction of the Sansome case. Although that case is based upon denial of the idea that "what was not 'recognized' as a sale or disposition for the purpose of fixing gain or loss should be 'recognized' as changing accumulated profits into capital," it does not seem, under the facts in the instant case that there is any such change; rather, there appears in the majority opinion a conversion of purchased property into earnings and profits. Where, as here, the greater portion of the new company's capital was raised by sale of stock having no
45 connection with the old corporations, there clearly appears difficulty in identifying a later distribution by such new

[5] The rule in the Sansome case has, except for the Crandall case, supra, been followed or approved without qualification in every jurisdiction, so far as we know, in which the question has been raised. Geerday Enterprises, Ltd. v. Commissioner, 128 Fed. (2d) 384; Corrigan v. Commissioner, 103 Fed. (2d) 1010; cert. den., 308 U. S. 576; Baker v. Commissioner, 80 Fed. (2d) 813; Harter v. Helvering, 79 Fed. (2d) 12; Murchison Estate v. Commissioner, 76 Fed. (2d) 641; United States v. Kaufmann, 62 Fed. (2d) 1045; Barnes v. United States, 22 Fed. Supp. 282; Hoyt v. Crocker, supra. See Commissioner v. Wheeler et al., Exrs., supra.

corporation as not out of such new capital, but from the earnings and profits of the old corporation, most particularly where realism seems to require a balancing of cash paid against earnings and profits allegedly acquired. The old stockholders receiving, in addition to stock in the new corporation, large amounts of cash, they seem in fact to have realized upon the earnings and profits of the former corporation to that extent. For the purpose of the present question, the result would not be different if the former corporation kept its earnings and profits, and the new corporation kept its capital in the same amount, in which case later distribution would be pro tanto from such capital.

In my opinion, the record here shows the substance of a distribution of the earnings and profits of the former corporation to its stockholders to the extent that cash paid equaled such earnings and profits, and I do not think that the general idea of nonrecognition of gain or loss in connection with a reorganization should be carried so far as to brand the distributions here as from earnings and profits. Examination of all the cases cited in Campbell v. United States, 144 Fed. (2d) 177, indicates that none involves a situation where new capital is raised by the issuance of new stock and resultant change in proportion of holdings and financial structure. I make no exception of Helen V. Crocker, 29
46 B. T. A. 773, for therein, although the new corporation had authorized capital stock of 10,000,000 shares of $1.00 each, the opening entries on its books showed capital stock of $3,169,266, which is the aggregate par value of the shares issued to the two predecessor corporations. It appears that 900 shares were also issued to the incorporators for cash, but whether these were included in the 3,169,266 shares appears uncertain, and in any event, the number is so small by comparison with the total number issued that I can not consider the case of weight on the present question. The conclusion in Campbell v. United States, supra, is based in part upon the idea that the cash received by the old stockholders had the effect of distribution of a taxable dividend, and so a distribution of the earnings. With that idea we agree in Knapp Monarch Co., 1 T. C. 59, a recapitalization case; also in Estate of Edward T. Bedford, 1 T. C. 478 (also recapitalization). The latter was reversed in Estate of Bedford v. Commissioner, 144 Fed. (2d) 272 (certiorari granted, January 8, 1945), because the Circuit Court considered the distribution, because of earlier stock dividends, to be in partial liquidation. In both cases we emphasized that there were earnings and profits sufficient to cover the distribution. Obviously, then, we considered that the distribution would be from, and reduce, such earnings and profits. Thus it appears that the cash received in addition to stock in reorganiza-

tion does not escape tax, and that therefore the basic thought in the Sansome case, escape from tax because of reorganization-nonrecognition of gain, has no application, so far as
47 concerns any cash also received in addition to stock, by the stockholder—an element altogether foreign to the situation in the Sansome case.

I see no reason to apply that case and would hold that the distribution in 1940 here in question was from capital. I therefore dissent.

48 In the Tax Court of the United States, Washington

Docket No. 1162

SIDNEY S. MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Decision

Pursuant to the determination of the Court, as set forth in its Opinion promulgated May 23, 1945, it is

Ordered and decided: That there is a deficiency in income tax for the calendar year 1940 in the amount of $9,596.33.

(Signed) J. RUSSELL LEECH,
Judge.

Entered May 23, 1945.

49 In the Tax Court of the United States

[File endorsement omitted.]

Docket No. 1162

SIDNEY S. MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for review

Filed June 8, 1945

Sidney S. Munter, the above-named petitioner, a resident of Pittsburgh, Allegheny County, Pennsylvania, hereby petitions

for review by the United States Circuit Court of Appeals for the Third Circuit of the decision entered May 23, 1945, by The Tax Court of the United States determining a deficiency in petitioner's income tax for the calendar year 1940.

SAMUEL KAUFMAN,
522 Oliver Building, Pittsburgh, Pennsylvania,
Attorney for Petitioner.

50 In the United States Circuit Court of Appeals for the Third Circuit

[File endorsements omitted.]

Docket No. 1162

SIDNEY S. MUNTER, PETITIONER ON REVIEW

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT ON REVIEW

Notice of filing petition for review

Filed June 8, 1945

To: J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

You are hereby notified that Sidney S. Munter did, on the 8th day of June 1945, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Third Circuit, of the decision of this Court heretofore rendered in the above-entitled case. Copy of the petition for review as filed is hereto attached and served upon you.

Dated this 8th day of June 1945.

B. D. Gamble.
B. D. GAMBLE,
Clerk, the Tax Court of the United States.

Service of copy of petition for review acknowledged this June 9, 1945.

(Signed) J. P. Wenchel.
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

51 In the Tax Court of the United States

[File endorsement omitted.]

Docket No. 1162

SIDNEY S. MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Designation of contents of record on review

Filed June 8, 1945

The above-named petitioner hereby designates for inclusion on review the complete record, as follows:

1. The relevant docket entries in The Tax Court.
2. Petition.
3. Answer.
4. Stipulation of Facts and Exhibit.
5. Opinion of The Tax Court.
6. Decision of The Tax Court.
7. Petition for Review.
8. This designation.

SAMUEL KAUFMAN,
Samuel Kaufman,
522 Oliver Building, Pittsburgh, Pennsylvania,
Attorney for Petitioner.

Service of a copy of the within designation is hereby admitted this 20th day of June 1945.

J. P. Wenchel,
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

52 [Clerks' Certificate to foregoing transcript omitted in printing.]

54 In The Tax Court of the United States

Docket No. 1163

CARL MUNTER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances: For Taxpayer: Samuel Kaufman, Esq., for Comm'r.: R. C. Whitley, Esq., Homer S. Benson, Esq., Orris Bennett, Esq.

Docket entries

1943

Apr. 5—Petition received and filed. Taxpayer notified. Fee paid.

Apr. 5—Copy of petition served on General Counsel.

Apr. 5—Request for hearing at Pittsburgh, Pa., filed by taxpayer. 4/5/43 Granted.

May 15—Answer filed by General Counsel.

May 19—Copy of answer served on taxpayer—Pittsburgh, Pa.

1944

Jan. 6—Hearing set Feb. 7, 1944—Pittsburgh, Pa.

Feb. 7—Hearing had before Judge Smith, on motion of petitioner's counsel to continue to next Pittsburgh calendar. Motion granted.

Feb. 25—Transcript of hearing 2/7/44 filed.

Mar. 7—Hearing set April 24, 1944—Pittsburgh, Pa.

Apr. 4—Motion for continuance to next Pittsburgh, Pa., calendar filed by taxpayer.

Apr. 4—Hearing set April 12, 1944, on motion.

Apr. 4—Copy of motion and notice of hearing served on General Counsel.

Apr. 12—Hearing had before Judge Murdock on petitioner's motion for continuance to Fall calendar.

Apr. 12—Motion of April 4, 1944, for continuance, granted to next Fall calendar. Pittsburgh, Pa.

Sept. 25—Hearing set Oct. 23, 1944—Pittsburgh, Pa.

Oct. 30—Hearing had before Judge Leech on merits. Motion of counsel to consolidate—granted. Stipulation of facts filed. Petitioner's brief due 12/11/44. Petitioner's reply due 1/24/45. Comm'rs. brief 1/18/45.

Nov. 30—Motion for extension to Jan. 17, 1945, to file brief, filed by taxpayer. 12/1/44 granted.

Nov. 27—Transcript of hearing Oct. 30, 1944, filed.

1945

Jan. 19—Brief filed by taxpayer. 1/19/45 Copy served.

Feb. 17—Motion for leave to file the attached brief, brief lodged, filed by General Counsel. 2/19/45 Granted.

May 22—Opinion rendered, Judge Leech. Decision will be entered for the respondent. Copies served.

May 23—Decision entered. Judge Leech, Div. 6.

June 8—Petition for review by U. S. Circuit Court of Appeals, 3rd Circuit, filed by taxpayer.

June 8—Designation of contents of record filed by taxpayer.

June 8—Notice of filing petition for review sent to J. P. Wenchel filed.

June 12—Proof of service filed.
June 20—Proof of service of designation of contents of record filed.
July 17—Order extending time for transmission and delivery of the record to August 31, 1945, entered.

56 In the Tax Court of the United States

[File endorsement omitted.]

Docket No. 1163

CARL MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition

Filed April 5, 1943

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT: WPM NCD-90D) dated January 7, 1943, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual with residence at 1325 Squirrel Hill Avenue, Pittsburgh, Pennsylvania. The return for the period here involved was filed with the Collector for the 23rd District of Pennsylvania.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A), was mailed to the petitioner on January 7, 1943.

3. The taxes in controversy are income taxes for the calendar year 1940 and in the amount of $8,175.50.

57 4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) Addition to income of "dividends" received from Crandall, McKenzie & Henderson, Inc., in the amount of $12,500.00.

(b) Increase of income from partnership in the amount of $549.26.

(c) Disallowance of deduction for legal fees in the amount of $4,500.00.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) Throughout the year 1940 petitioner and his brother, Sidney S. Munter, were partners engaged in the operation of a laundry business in the City of Pittsburgh, Pennsylvania.

(b) In April 1940, petitioner and his brother, Sidney S. Munter, acquired by purchase 20,000 shares (a majority) of the capital stock of Crandall, McKenzie & Henderson, Inc., a Pennsylvania corporation, engaged in the dry cleaning business in the City of Pittsburgh, Pennsylvania, and held these shares throughout the remainder of 1940.

(c) Petitioner and his brother, Sidney S. Munter, became officers and employees of Crandall, McKenzie & Henderson, Inc., and in 1940 received compensation for services rendered to the corporation in the respective amounts of $3,403.48 and $6,000.00.

58 (d) The oral agreement between petitioner and his brother provided that they should be equal partners not only in the conduct of the laundry business, the income from which was reflected on a partnership return, but as to the acquisition, ownership, management and operation of the affairs of Crandall, McKenzie & Henderson, Inc., including the respective salaries received by them from the corporation.

(e) In connection with the purchase of the shares of Crandall, McKenzie & Henderson, Inc., and the borrowing of funds to finance the purchase, legal fees were incurred in 1940 in the amount of $9,000.00.

(f) Subsequent to April 1940 Crandall, McKenzie & Henderson, which had neither accumulated nor current earnings or profits, distributed to its shareholders cash in the amount of $1.25 per share.

(g) In its fiscal year ended May 31, 1940, the partnership, composed of petitioner and his brother, paid a bonus of $200.00 to one of its employees and distributed among all of its employees Christmas candy costing $353.52, deduction for which was disallowed by the respondent.

WHEREFORE, the petitioner prays that this Court may hear the proceeding and disallow the deficiency.

Samuel Kaufman,
SAMUEL KAUFMAN,
RUSLANDER AND KAUFMAN,
First National Bank Bldg., Pittsburgh, Pennsylvania,
Counsel for Petitioner.

59 [*Duly sworn to by Carl P. Munter; jurat omitted in printing.*]

60 *Exhibit A to petition*

TREASURY DEPARTMENT

INTERNAL REVENUE SERVICE,
2300 FARMERS BANK BUILDING,
Pittsburgh, Pennsylvania, January 7, 1943.

Office of Internal Revenue Agent in Charge, Pittsburgh Division
IT:WPM.
NCD-90D.

MR. CARL MUNTER,
5562 Hobart Street, Pittsburgh, Pennsylvania.

SIR: You are advised that the determination of your income tax liability for the taxable year 1940 discloses a deficiency of $8,175.50 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency mentioned.

Within 90 days (not counting Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, Pittsburgh, Penna., for the attention of IT:WPM-NCD. The signing and filing of this form will expedite the closing of your return by permitting an early assessment of the deficiency, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.

By (Signed) W. P. MAYS,
Internal Revenue Agent in Charge.

Enclosures: Statement
Form of waiver.
NCD-MMM.

61 TAX LIABILITY FOR THE TAXABLE YEAR ENDED DECEMBER 31, 1940

	Liability	*Assessed*	*Deficiency*
Income tax	$8,114.36	$9,938.86	$8,175.50

In making this determination of your income tax liability, careful consideration has been given to the report of examination dated January 15, 1942; to your protest dated June 9, 1942; and

to the statements made at the conferences held on August 26, 1942 and December 16, 1942.

A copy of this letter and statement has been mailed to your representative, Mr. Samuel Kaufman, First National Bank Building, Pittsburgh, Pennsylvania, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

ADJUSTMENTS TO NET INCOME

Net income as disclosed by return		$40,857.64
Unallowable Deductions and Additional Income:		
(a) Dividends increased	$12,500.00	
(b) Partnership income increased	549.26	
(c) Legal fees decreased	4,500.00	
		17,549.26
Total		58,406.90
Nontaxable Income and Additional Deductions:		
(d) Salary income decreased		801.41
Net income as adjusted		57,605.49

EXPLANATION OF ADJUSTMENTS

(a) It is held that dividends received by you from Crandell, McKenzie & Henderson, Inc. in the amount of $12,500.00 in the year 1940 are one hundred percent taxable.

62 (b) Your share of the net income from the partnership firm of Sweet Clean-Perfect Laundries has been adjusted as follows:

Net income as disclosed by partnership return		$87,700.04
Unallowable deductions and additional income:		
(1) Loss on trade-in decrease	$545.00	
(2) Gifts decreased	553.52	
		1,098.52
Net income of partnership adjusted		88,598.56

EXPLANATION OF ADJUSTMENTS

(1) The loss reported from the exchange of equipment has been disallowed in accordance with the provisions of Section 112 (b) 1 Internal Revenue Code.

Cost of old equipment	$1,800.00
Depreciation allowed	360.00
Depreciation value	1,440.00
Allowance in exchange	895.00
Loss claimed which has been disallowed	545.00

(2) The deduction claimed for gifts made during the year has been disallowed as not being an ordinary and necessary business

expense within the provisions of Section 19.23 (a)–1 Internal Revenue Code.

Bonus paid Mr. Logan	$200.00
Candy for employees	353.52
Total	553.52

Your distributive share of the adjusted net income of the partnership is 50 percent or $44,299.28.

(c) It is held that the amount of $4,500.00 deducted by you in your 1940 income tax return as legal fees represents a personal expenditure which may not be deducted in computing your net income for that year.

(d) It is further held that the salary received by you from Crandall, McKenzie & Henderson, Inc., in the year 1940 is the amount of $3,900.33 is taxable to you in its entirety.

Salary reported on your income tax return	$4,701.74
Salary actually received during 1940	3,900.33
Net decrease allowed	801.41

The credit claimed on your income tax return for personal exemption in the amount of $2,000.00 has been decreased by $10.00, inasmuch as you were not married until February 11, 1940.

This adjustment is in accordance with the provisions of Section 19.25 (b)–3 Internal Revenue Code.

Married exemption 11/12 of $2,000.00	$1,833.33
Single exemption 1/12 of $800.00	66.67
Adjusted exemption	1,900.00

COMPUTATION OF TAX

Net income adjusted	$57,605.49
Less: Personal exemption	1,900.00
Balance (surtax net income)	55,705.49
Less: Earned income credit (10% of $12,700.19)	1,276.02
Net income subject to normal tax	54,429.47
Normal tax at 4% on $54,429.47	2,177.18
Surtax on $55,705.49 (Amount in excess of $4,000.00)	14,290.42
Total tax (ordinary)	16,467.60
Defense tax (10% of $16,467.60)	1,646.76
Total income and defense taxes	18,114.36
Corrected tax liability	18,114.36
Income tax assessed: Original, account No. 204700	9,938.86
Deficiency of income tax	8,175.50

NCD/MMM

64 In the Tax Court of the United States

[File endorsement omitted.]

Docket No. 1163

CARL MUNTER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Answer

Filed May 15, 1943

NOW comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition in the above-entitled proceeding admits and denies as follows:

1. Admits the allegations of paragraph 1 of the petition.

2. Admits the allegations of paragraph 2 of the petition.

3. Admits the allegations of paragraph 3 of the petition.

4. (a) Denies the allegations of paragraph 4 (a) of the petition. (b) Denies the allegations of paragraph 4 (b) of the petition. (c) Denies the allegations of paragraph 4 (c) of the petition.

5. (a) Admits the allegations of paragraph 5 (a) of the petition.

(b) Admits that in 1940 petitioner acquired by purchase shares of the capital stock of Crandall, McKenzie & Henderson, Inc., a Pennsylvania corporation; denies all other allegations of paragraph 5 (b) of the petition.

(c) Admits petitioner became an officer and employee of Crandall, McKenzie & Henderson, Inc., and in 1940 received compensation for services rendered to the corporation; denies the remaining allegations of paragraph 5 (c) of the petition.

65 (d) Denies the allegations of paragraph 5 (d) of the petition.

(e) Denies the allegations of paragraph 5 (e) of the petition.

(f) Admits that subsequent to April 1940, Crandall, McKenzie & Henderson, Inc., distributed to its stockholders cash in the amount of $1.25 per share; denies all other allegations of paragraph 5 (f) of the petition.

(g) Denies the allegations of paragraph 5 (g) of the petition.

6. Denies generally each and every allegation of the petition not hereinabove specifically admitted, qualified, or denied.

Wherefore, it is prayed that the petition be denied.

(Signed) J. P. Wenchel,
OB
J. P. Wenchel,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:
Hartford Allen,
Division Counsel,
J. Harrison Miller,
Special Attorney,
Bureau of Internal Revenue.
amh: 5/12/43.

66 In the Tax Court of the United States, Washington

Docket No. 1163

Carl Munter, petitioner

v.

Commissioner of Internal Revenue, respondent

Decision

Pursuant to the determination of the Court, as set forth in its Opinion promulgated May 22, 1945, it is

Ordered and decided: That there is a deficiency in income tax for the calendar year 1940 in the amount of $8,175.50.

(Signed) J. Russell Leech,
Judge.

Entered May 23, 1945.

67 In the Tax Court of the United States

[File endorsement omitted.]

Docket No. 1163

Carl Munter, petitioner

v.

Commissioner of Internal Revenue, respondent

Petition for review

Filed June 8, 1945

Carl Munter, the above-named petitioner, a resident of Pittsburgh, Allegheny County, Pennsylvania, hereby petitions for

review by the United States Circuit Court of Appeals for the Third Circuit of the decision entered May 23, 1945, by The Tax Court of the United States determining a deficiency in petitioner's income tax for the calendar year 1940.

SAMUEL KAUFMAN,
522 Oliver Building, Pittsburgh, Pennsylvania,
Attorney for Petitioner.

68 In the United States Circuit Court of Appeals for the Third Circuit

[File endorsements omitted.]

Docket No. 1163

CARL MUNTER, PETITIONER ON REVIEW

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT ON REVIEW

Notice of filing petition for review

Filed June 8, 1945

To J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

Your are hereby notified that Carl Munter did, on the 8th day of June 1945, file with the Clerk of The Tax Court of the United States, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Third Circuit, of the decision of this Court heretofore rendered in the above-entitled case. Copy of the petition for review as filed is hereto attached and served upon you.

Dated this 8th day of June 1945.

B. D. Gamble.
B. D. GAMBLE,
Clerk, the Tax Court of the United States.

Service of copy of petition for review acknowledged this June 9, 1945.

(Signed) J. P. Wenchel.
J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue,
Attorney for Respondent.

69 United States Circuit Court of Appeals for the Third Circuit

No. 9010—October Term, 1945

SIDNEY S. MUNTER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

No. 9011—October Term, 1945

CARL MUNTER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petitions for Review of the Decisions of the Tax Court of the United States

Argued November 20, 1945

Before BIGGS, McLAUGHLIN and O'CONNELL, Circuit Judges

Opinion of the court

Filed August 7, 1946

By McLAUGHLIN, Circuit Judge.

On March 21, 1940, the petitioners each purchased from O. McKenzie 10,000 shares of the common stock of Crandall-McKenzie & Henderson, Inc., a Pennsylvania corporation, paying therefor $8.00 per share. The total outstanding capital stock of the corporation at the time was 38,922 shares, exclusive of 11,078 shares of treasury stock. On June 19, 1940, the corporation distributed to its common stockholders cash in the amount of $35,466.25 at the rate of $1.25 a share of which each petitioner received $12,500 with respect to the 10,000 shares held by him. These sums were held by the Commissioner to be taxable to the petitioners as an ordinary dividend. The Tax Court sustained the Commissioner.

In 1928, under an agreement with investment bankers, two corporations, Crandall-McKenzie Co. and L. Henderson & Sons, Inc., were reorganized into the above-mentioned Crandall-McKenzie & Henderson, Inc. At the end of the process, old company stockholders held 45% of the stock of the new corporation.

70 Over half of the 50,000 shares issued were purchased by new investors for approximately $486,875.92. The stockholders

of Crandall-McKenzie Co. received 14,607 shares and $355,247.75 for the shares (par value $10) and upon dissolution, the assets of that concern.[1] The shares and assets of L. Henderson & Sons, Inc., were acquired solely for 9,524 shares of the new corporation. At the time, Crandall-McKenzie Co. had earnings and profits accumulated subsequent to March 1, 1913, of $329,267.95 and L. Henderson & Sons, Inc., had similar earnings and profits of $74,743.62, making a total of $404,011.57 earnings and profits taken over by the successor corporation.[2] From the date of the organization until the end of 1939, the new company had aggregate earnings and profits of $401,470.07. During that period it made cash distributions of $369,452.30 to shareholders and liquidated or purchased 11,078 of its own ($1 par value) stock for $72,211.13 cash. In 1940 it had a net loss of $37,252.47 and liquidated or purchased 12,805 shares of its own stock for $94,141.90 in cash.[3] Also in 1940 it made the distribution on which the tax in question was levied.[4]

We agree with the Tax Court that the acquisition of all of the assets of the two old companies by Crandall-McKenzie & Henderson, Inc., constituted a reorganization under Section 112 (i). (1) (A) of the applicable Revenue Act of 1928. Petitioners' argument though not so conceding assumes this to be so.

The Tax Court held that the earnings and profits of the two old corporations amounting to $404,011.57 were taken over by the successor company. From this it concluded that the latter had sufficient earnings to cover its 1940 distribution which therefore was an ordinary dividend as to petitioners and taxable as such. In so doing it relied chiefly upon Commissioner vs. Sansome, 60 F. 2d 931 (C. C. A. 2), certiorari denied, Sansome vs. Burnet, 287 U. S. 667. In that case the stock of a new corporation was exchanged for the assets of its predecessor without change in proportion of stockholdings and no other change in the financial structure. The Court decided that in such situation the earn-

[1] This transaction was in itself a series of purchases and exchanges between various stockholders. One of the leading old holders, apparently unfavorable to the plan, had to be bought out by another holder, O. McKenzie. The first sold 842½ old shares to McKenzie for $300,000. The new company then bought them for the same price and gave McKenzie 12,181 shares for 842½ shares of his own old stock.

[2] No purpose would be served by attempting to treat these sums separately. The circumstances that no cash was given in return for the L. Henderson profits does not justify such separate treatment, especially since Section 112 (e) of the Revenue Act of 1928, involved in the holding below, does not enter into our decision. When and if these sums were paid out later as dividends their detailed source would be immaterial. Section 115 (b) I. R. C.; Helen vs. Crocker, 29 B. T. A. 777. The reorganization being a single transaction (Starr vs. Commissioner, 82 F. 2d 964 (C. C. A. 4)), only the total earnings and profits arrived at upon its conclusion appears pertinent.

[3] The Tax Court did not determine whether the sums expended in liquidating purchases should be subtracted from accumulated earnings and profits. This was unnecessary to the decision below and is not important to the result arrived at here.

ings and profits of the old corporation were later so taxable
71 upon distribution to the successor company in the form of dividends.[4] That rule is now well settled tax law.[4] It was discussed at length by Judge Maris for this Court in Campbell vs. United States, 144 F. 2d 177. There the plaintiff and other stockholders who paid cash for their shares came into the corporate set-up as a result of the reorganization, and the proportionate ownership of the stockholders of the two old companies in the successor corporation was reduced to a fraction of their interest in the former companies. In stating the first of the two reasons which distinguished the Campbell facts from Sansome vs. Commissioner,[5] Judge Maris said, at page 180:

"The identity of proprietary interest which existed in the Sansome case and motivated the court to disregard the corporate entities and treat the earnings of the predecessor corporation as though they were earnings of the successor corporation is, therefore, completely lacking. We think that for this reason alone the doctrine of the Sansome case, which by judicial construction operates to transfer earnings from the corporation which earned them to its successor in reorganization, is inapplicable."

On the same point with reference to the extension of the Sansome rule the Court further said:

"We are aware that it has also been applied to transfers of corporate assets which, while constituting tax-free reorganizations within the meaning of the revenue act, none the less involved the introduction of new capital and new stockholders into the corporate picture with consequent changes in the proportionate interests of the old stockholders in the enterprise. We cannot accede to such an extension of the Sansome doctrine, however, because it involves the contradictory concept of a corporation buying profits with money contributed by new stockholders, whereas profits by their nature must be realized from other transactions and may not themselves be acquired by purchase."

In the present matter new interests having no connection with the predecessor companies paid at least $486,893.92 cash for over 50% of the capital stock of Crandall-McKenzie & Henderson, Inc.

---

[4] Corrigan vs. Commissioner, 103 F. 2d 1019 (C. C. A. 3); certiorari denied, 308 U. S. 576, decided on the authority of Baker vs. Commissioner, 80 F. 2d 843 (C. C. A. 2); Gourley Enterprises vs. Commissioner, 126 F. 2d 384 (C. C. A. 4); Murchesons Estate vs. Commissioner, 76 F. 2d 643 (C. C. A. 5); United States vs. Kaufman, 62 F. 2d 1047 (C. C. A. 9).

[5] Since this case is squarely under the first exception in Campbell it is sufficient for the purposes of this opinion to simply state the second exception as set out in the Campbell opinion, page 181:

"The doctrine of the Sansome case that the accumulated earnings of the predecessor corporation in a tax free reorganization shall be deemed carried over to the successor corporation for the purpose of distribution to its stockholders as dividends cannot apply to a situation where the accumulated earnings of the predecessor corporation have been distributed to its stockholders at the time of the reorganization. Obviously earnings cannot at one and the same time be distributed to the stockholders of the predecessor corporation and transferred to the successor corporation."

Of that sum, $355,247.75 was paid in addition to stock, for
72 the old Crandall-McKenzie assets. The earnings of that concern amounted to $329,267.95. The L. Henderson & Sons, Inc., earnings totaled $74,743.62. As seen the new corporation not only differed radically from its two predecessors but actually paid out in cash to one of them more than the latter's earnings and profits though less than the combined earnings and profits of both old corporations. The Tax Court recognizes that the facts are directly within the first branch of the Campbell decision but contends for the general application of the Sansome principle. It cites Helen vs. Crockett, 29 B. T. A. 773, but in that matter the new corporation seems to have exchanged its stock substantially share for share with that of its predecessor corporation. The only other cases cited where the successor company is said to have new stockholders are Putnam vs. United States, 149 F. 2d 721 (C. C. A. 1) and Reed Drug Co. vs. Commissioner, 130 F. 2d 288 (C. C. A. 6). Both of these are readily distinguishable from the instant problem. In Putnam the acquiring corporation was already established, there was not cash involved in the obtaining of the stock, and the "proportionate proprietary interest" of the owners of the corporation and partnership taken over was "maintained". In Reed the new company was formed to absorb the old concern and several other corporations in the same business. The old corporation exchanged its assets for stock in the new, there was no cash in the transaction nor does it appear that the proportionate proprietary interest of the old company stockholders was disturbed.

We think this reorganization is entitled to be judged on its own particular facts. In none of the decisions extending the Sansome doctrine do we find the situation that appears in Campbell vs. United States and in the pending issue. The Campbell opinion is still the law of this Circuit. It controls the question under consideration. The finding below is directly contrary to it and therefore must be reversed.

Dissenting opinion

O'CONNELL, Circuit Judge, dissenting.

I cannot concur in the conclusions reached by the majority. Since a reversal of the Tax Court's rulings is placed squarely on Campbell vs. United States, 144 F. 2d 177 (C. C. A. 3, 1944), consideration of that case is required.

As I understand the Campbell case, this court, per Judge Maris, found two reasons why the undistributed earnings of a corporation were not transferred over for tax purposes to a successor corporation in a tax-free reorganization. The first was that "The

identity of proprietary interests which existed in the Sansome case" was lacking in the Campbell reorganization. The second was "the accumulated earnings of the predecessor corpora-
73 tion have been distributed to its stockholders at the time of the reorganization." Campbell vs. United States, supra, 144 F. 2d at 180, 181. There were thus alternative bases for the Campbell ruling.

Acquiescing in principle in the second basis for that decision, I am compelled to disagree with the first, if it was meant to be laid down as a criterion to be applied in other cases. Stripping aside the language necessary for the solution of the perplexing problem of statutory construction in the Sansome case, I believe that the real basis for that ruling is the prevention of tax evasion. See Putnam vs. United States, 149 F. 2d 721, 726 (C. C. A. 1, 1945). By judicial interpretation, later sanctioned by Congress (see S. Rep. No. 2156, 74th Cong., 2d Session, p. 19 (1939–1 Cum. Bull. (Part 2) 678–690)), the general rule has evolved that where one corporation acquires all the assets and assumes all the existing obligations of another corporation in a tax free reorganization, the undistributed earned surplus of the transferor becomes the undistributed earned surplus of the transferee and is subject to taxation as a dividend on subsequent distribution to the stockholders of the transferee. The factor of vital importance in the application of this general rule is the distribution of earned corporate surplus which had not previously been distributed. Such earnings do not disappear, and the rule of Sansome which has been "adopted in this circuit and has been followed in every circuit in which the question has been determined," Campbell v. United States, supra, 144 F. 2d at p. 179, has laid to rest the question of capitalization of accumulated earnings through the device of reorganization. Identity of the distributee is no more material than identity of the distributor. Any distribution made by a corporation to its shareholders out of its earnings and profits accumulated after February 28, 1913, is a dividend. Section 115 (a), Internal Revenue Code.[2] Gross income includes income from dividends. Section 22 (a), Internal Revenue Code.[3] We have long since passed the stage where taxability of dividends distributed to those who became shareholders after the corporate earnings or profits came into existence is even questioned. See United States v. Phellis, 257 U. S. 156, 171–172 (1921); Taft v. Bowers, 278 U. S. 470, 484 (1929). Thus, that the profits had already been earned when petitioners purchased their shares in 1940 is immaterial. Cf. Commissioner v. Sansome, 60 F. 2d 931, 932: "Under the Sansome rule, earnings or profits which pass

[2] 26 U. S. C. A. § 115 (a).
[3] 26 U. S. C. A. § 22 (a).

to a successor company are taxable as dividends on subsequent distribution. It does not matter who received them": Putnam v. United States, supra, 149 F. 2d at p. 727.

74 In my view this case narrows down to this: Two companies (one will be referred to herein as "Crandall" and the other as "Henderson") are reorganized into a third (called the "New Corporation" herein), with the reorganization resulting in a possibly recognizable distribution of Crandall's earnings but with no distribution whatsoever of Henderson's earnings. None of the $355,247.75 in cash which passed in this transaction came out of Henderson's earnings. Indeed, the Tax Court found that all of the assets of Henderson were acquired by the New Corporation solely in exchange for 9.524 shares of its stock. The Tax Court also found that at the time of this acquisition, Henderson had earnings and profits of $74,743.62 accumulated subsequent to March 1, 1913.

On March 21, 1940, the petitioners purchased their shares in the New Corporation. On June 19, 1940, the New Corporation distributed to its common shareholders cash in the amount of $85,166.25, of which petitioners received $25,000 between them. Whether the accumulated earnings (without regard to the earnings of Crandall, but including the earnings of Henderson), considering the Treasury Stock purchased and held and the possibility of loss up to June 1940 (the company's loss for the year 1940 was $37,252.47), were sufficient to cover such distribution is for determination by the trier of the facts. If so found, it follows that what the petitioners received was dividends in accordance with the Sansome doctrine. Cf. Campbell v. United States, supra, Judge Jones' dissent, 144 F. 2d at p. 184.

Accordingly, I should reverse and remand to the Tax Court for such determination.

In the United States Circuit Court of Appeals for the Third Circuit

No. 9010—October Term, 1945

SIDNEY S. MUNTER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

Present: BIGGS, McLAUGHLIN, and O'CONNELL, Circuit Judges.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

75. On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby reversed.

By the Court.

McLAUGHLIN,
Circuit Judge.

AUGUST 7, 1946.

Endorsements.

(Order Reversing Decision of Tax Court. Received & Filed, August 7, 1946. William P. Rowland, Clerk.)

In the United States Circuit Court of Appeals for the Third Circuit

No. 9011—October Term, 1945

CARL MUNTER, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Judgment

PRESENT: BIGGS, McLAUGHLIN, and O'CONNELL, Circuit Judges.

This cause came on to be heard on the transcript of record from the Tax Court of the United States, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the decision of the said Tax Court in this cause be, and the same is hereby reversed.

By the Court.

McLAUGHLIN,
Circuit Judge.

AUGUST 7, 1946.

Endorsements.

(Order Reversing Decision of Tax Court. Received & Filed, August 7, 1946. William P. Rowland, Clerk.)

[Clerk's Certificate to foregoing transcript omitted in printing.]

76 In the Supreme Court of the United States

October Term, 1946

Nos. — and —

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SIDNEY S. MUNTER

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CARL MUNTER

Stipulation

Subject to the approval of this Honorable Court, it is hereby stipulated and agreed by and between the attorneys for the parties in the above-entitled causes that, for the purpose of the petition for writs of certiorari, the printed record may consist of the following:

1. The appendix to the brief for the petitioners in the United States Circuit Court of Appeals for the Third Circuit.

2. The proceedings before the United States Circuit Court of Appeals for the Third Circuit.

It is further stipulated and agreed that the petitioner will file the entire transcript of the record now on file in the office of the Clerk of the United States Circuit Court of Appeals for the Third Circuit with the Clerk of the United States Supreme Court, and that in the event the petition for writs of certiorari is granted the printed record shall consist of the proceedings in the court below and such portions of the entire transcript of the record certified by the Clerk of the United States Circuit Court of Appeals for the Third Circuit as the respective parties may designate. It is further agreed that either party may, in the

77 petition and briefs, refer to any portions of the typewritten transcript of record which is not included in the printed record filed with this Court.

J. Howard McGrath,
J. HOWARD MCGRATH,
Solicitor General,
Counsel for Petitioner.

SAMUEL KAUFMAN,
Counsel for Respondents.

Dated this 29 Day of October 1946.

78 Supreme Court of the United States

No. 674, October Term, 1946

Order allowing certiorari

Filed December 16, 1946

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

79 Supreme Court of the United States

No. 675, October Term, 1946

Order allowing certiorari

Filed December 16, 1946

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

80 In the Supreme Court of the United States

October Term, 1946

No. 674

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

SIDNEY S. MUNTER, RESPONDENT

No. 675

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CARL MUNTER, RESPONDENT

Stipulation

Filed February 7, 1947

Subject to this Court's approval, it is hereby stipulated and agreed by and between the attorneys for the respective parties

hereto, that for the consideration of this case on the writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit, granted December 16, 1946, the printed record may consist of the following:

1. Transcript of all proceedings in the Tax Court in Sidney S. Munter v. Commissioner of Internal Revenue (Tax Court Docket No. 1162).

2. All proceedings in the Circuit Court of Appeals for the Third Circuit covering both cases.

3. Docket entries in Carl Munter v. Commissioner of Internal Revenue (Tax Court Docket No. 1163).

4. Taxpayer's petition for redetermination the Tax Court, with notice of deficiency by Commissioner attached, in Carl Munter v. Commissioner of Internal Revenue (Tax Court Docket No. 1163).

5. Commissioner's answer in the Tax Court in Carl Munter v. Commissioner of Internal Revenue (Tax Court Docket No. 1163).

6. Petition for review by the Circuit of Appeals for the Third Circuit and notice of service, in Carl Munter v. Commissioner of Internal Revenue (Tax Court Docket No. 1163).

7. This stipulation.

It is further agreed that in the briefs for either party reference may be made to any portion of the transcript of record which is not included in the printed record prepared as aforesaid.

George T. Washington,
GEORGE T. WASHINGTON,
Acting Solicitor General,
Attorney for Petitioner.

Dated this 15th day of January, 1947.

Samuel Kaufman,
SAMUEL KAUFMAN,
Attorney for Respondents.

Dated this 31st day of January, 1947.

[Endorsement on cover:] File Nos. 51,538, 51,539. U. S. Circuit Court of Appeals; Third Circuit. Term No. 674. Commissioner of Internal Revenue, Petitioner, vs. Sidney S. Munter. Term No. 675. Commissioner of Internal Revenue, Petitioner, vs. Carl Munter. Petition for writs of certiorari and exhibit thereto. Filed November 6, 1946. Term Nos. 674 O. T. 1946, 675 O. T. 1946.

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